



USDA Foreign Agricultural Service

# GAIN Report

Global Agriculture Information Network

Template Version 2.09

Required Report - public distribution

**Date:** 11/14/2005

**GAIN Report Number:** NZ5021

## New Zealand

### Dairy and Products

### Annual

### 2005

**Approved by:**

David Rosenbloom  
U.S. Embassy

**Prepared by:**

Alastair Patterson

---

**Report Highlights:**

New Zealand's milk production during the 2005/06 season (June-May) is forecast at 14.1 million tons, a 2 percent decline from the previous season. In August 2005, Fonterra purchased some dairy assets from New Zealand Dairy Foods. These included domestic ownership of the Anchor brand, which is one of Fonterra's key international brands outside New Zealand. Fonterra continues with its plans to become a leading player in the Australian dairy industry, with the consolidation of key brands and purchase of dairy assets.

---

Includes PSD Changes: Yes  
Includes Trade Matrix: Yes  
Annual Report  
Wellington [NZ1]  
[NZ]

**SECTION I. EXECUTIVE SUMMARY**

New Zealand's milk production during the 2005/06 season (June-May) is forecast at 14.1 million tons, a 2 percent decline from the previous season. This is the second season of low milk production in a row and is well below that of 2003/04. The decline is due to poor weather conditions, resulting in decreased production per cow. This is despite a small increase in cow numbers.

New Zealand's peak milk flow normally occurs in late October. This season it has instead occurred mid-October. This is despite early season predictions that it would occur later in the season due to an extended calving period. This early peak was the result of colder than normal conditions throughout New Zealand during the end of September and the month of October. Milk flows also decreased as a result of persistent rain and lower soil temperatures in some key North Island districts. Milk flows in the South Island have not been as adversely affected, but some areas are now facing drought conditions. As of the beginning of November, milk flows are approximately 2 percent below this time last season.

Fonterra purchased NZ\$ 754 million (U.S.\$ 524 million)<sup>1</sup> of assets from New Zealand Dairy Foods, in return selling the company NZ\$ 416 million (U.S.\$ 289 million) of its assets, in August 2005. The brands Fonterra purchased include Anchor, which is one of Fonterra's key international brands outside New Zealand, but was owned domestically by Dairy Foods. Fonterra views this as greatly beneficial to its long-term marketing goal of international brand consolidation. Fonterra outbid several competitors for the New Zealand Dairy Foods assets, including San Miguel, who it earlier lost out to in its bid for Australian dairy company National Foods.

Fonterra is fast becoming a leading player in the Australian dairy industry. Fonterra is consolidating its Australian interests under its fast moving consumer goods business 'Fonterra Brands'. Additionally, Australian based dairy company Bonlac became a wholly owned subsidiary of Fonterra on September 1, 2005. Fonterra also purchased a Nestlé plant in Victoria, Australia, which it will integrate into its manufacturing business. Following these acquisitions, Fonterra now controls 18 percent of Australia's milk supply. Fonterra is also investing A\$ 22 million to build a dairy research center in Melbourne. Construction is set to start in 2006, with completion expected in April 2007.

A large number of dairy cows were exported live in 2004. Of the 65,000 exported, nearly 60,000 animals went to China. Live animal sales to China weakened dramatically in 2005. For the year to August, only 7,000 animals have been exported to China, while 24,000 have gone to Mexico. Declining sales to China may represent a tightening of Chinese import regulations and poor 'after-sales service' by some New Zealand vendors. Analysts anticipate some animal shortages in New Zealand and domestic prices are now close to those that can be obtained by live export sales.

---

<sup>1</sup> Exchange rate August 2005: NZ\$ 1 = U.S.\$ 0.695

## SECTION II. STATISTICAL TABLES

### PS&D TABLES

New Zealand Dairy, Milk, Fluid						
	(1000 HEAD)(1000 MT)					
	<b>2004</b>	<b>Revised</b>	<b>2005</b>	<b>Estimate</b>	<b>2006</b>	<b>Forecast</b>
	USDA Official [Old]	Post Es timate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin		06/2003		06/2004		06/2005
Cows In Milk	3920	3920	3970	3970	0	4000
Cows Milk Production	15000	15000	14625	14400	0	14100
Other Milk Production	0	0	0	0	0	0
TOTAL Production	15000	15000	14625	14400	0	14100
Intra EC Imports	0	0	0	0	0	0
Total Imports	0	0	0	0	0	0
TOTAL Imports	0	0	0	0	0	0
TOTAL SUPPLY	15000	15000	14625	14400	0	14100
Intra EC Exports	0	0	0	0	0	0
Total Exports	50	50	50	55	0	50
TOTAL Exports	50	50	50	55	0	50
Fluid Use Dom. Consum.	360	360	360	360	0	360
Factory Use Consum.	14545	14545	14170	13940	0	13645
Feed Use Dom. Consum.	45	45	45	45	0	45
TOTAL Dom. Consumption	14950	14950	14575	14345	0	14050
TOTAL DISTRIBUTION	15000	15000	14625	14400	0	14100
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

Note: The data in the PS&D tables is based on more than one source. Some of the data, such as inventory levels, are estimates as this data is unavailable.

<b>New Zealand Dairy, Butter</b>						
	(1000 MT)					
	<b>2004</b>	<b>Revised</b>	<b>2005</b>	<b>Estimate</b>	<b>2006</b>	<b>Forecast</b>
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin		06/2003		06/2004		06/2005
Beginning Stocks	31	60	21	50	11	78
Production	407	390	336	345	0	330
Intra EC Imports	0	0	0	0	0	0
Total Imports	0	0	0	1	0	1
TOTAL Imports	0	0	0	1	0	1
TOTAL SUPPLY	438	450	357	396	11	409
Intra EC Exports	0	0	0	0	0	0
Total Exports	391	374	320	292	0	305
TOTAL Exports	391	374	320	292	0	305
Domestic Consumption	26	26	26	26	0	26
TOTAL Use	417	400	346	318	0	331
Ending Stocks	21	50	11	78	0	78
TOTAL DISTRIBUTION	438	450	357	396	0	409
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	29	29	30	28	0	30

<b>New Zealand Dairy, Cheese</b>						
	(1000 MT)					
	<b>2004</b>	<b>Revised</b>	<b>2005</b>	<b>Estimate</b>	<b>2006</b>	<b>Forecast</b>
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin		06/2003		06/2004		06/2005
Beginning Stocks	36	45	29	38	26	45
Production	313	308	293	300	0	295
Intra EC Imports	0	0	0	0	0	0
Total Imports	2	2	2	2	0	3
TOTAL Imports	2	2	2	2	0	3
TOTAL SUPPLY	351	355	324	340	26	343
Intra EC Exports	0	0	0	0	0	0
Total Exports	294	289	270	267	0	298
TOTAL Exports	294	289	270	267	0	298
Human Dom. Consumption	28	28	28	28	0	0
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	28	28	28	28	0	0
TOTAL Use	322	317	298	295	0	298
Ending Stocks	29	38	26	45	0	45
TOTAL DISTRIBUTION	351	355	324	340	0	343
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	41	41	40	32	0	30

New Zealand Dairy, Milk, Nonfat Dry						
	(1000 MT)					
	2004	Revised	2005	Estimate	2006	Forecast
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin		06/2003		06/2004		06/2005
Beginning Stocks	70	50	55	35	48	60
Production	301	294	237	250	0	240
Intra EC Imports	0	0	0	0	0	0
Total Imports	1	1	1	1	0	1
TOTAL Imports	1	1	1	1	0	1
TOTAL SUPPLY	372	345	293	286	48	301
Intra EC Exports	0	0	0	0	0	0
Total Exports	312	305	240	221	0	236
TOTAL Exports	312	305	240	221	0	236
Human Dom. Consumption	5	5	5	5	0	5
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	5	5	5	5	0	5
TOTAL Use	317	310	245	226	0	241
Ending Stocks	55	35	48	60	0	60
TOTAL DISTRIBUTION	372	345	293	286	0	301
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	1	1	1	1	0	1

New Zealand Dairy, Dry Whole Milk Powder						
	(1000 MT)					
	2004	Revised	2005	Estimate	2006	Forecast
	USDA Official	Post Estimate	USDA Official	Post Estimate	USDA Official	Post Estimate
	[Old]	[New]	[Old]	[New]	[Old]	[New]
Market Year Begin		06/2003		06/2004		06/2005
Beginning Stocks	63	85	53	75	48	140
Production	677	658	609	650	0	642
Intra EC Imports	0	0	0	0	0	0
Total Imports	2	2	2	1	0	1
TOTAL Imports	2	2	2	1	0	1
TOTAL SUPPLY	742	745	664	726	48	783
Intra EC Exports	0	0	0	0	0	0
Total Exports	688	669	615	585	0	642
TOTAL Exports	688	669	615	585	0	642
Human Dom. Consumption	1	1	1	1	0	1
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	1	1	1	1	0	1
TOTAL Use	689	670	616	586	0	643
Ending Stocks	53	75	48	140	0	140
TOTAL DISTRIBUTION	742	745	664	726	0	783
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	4	4	4	4	0	4

New Zealand Butter Exports (Tons)					
Partner Country	Calendar Year			Jan - Aug	
	2002	2003	2004	2004	2005
Belgium	67,640	71,053	45,496	34,772	32,015
Denmark	4,355	20,189	36,674	22,435	23,006
United States	19,683	21,334	34,044	23,370	13,915
Russia	24,173	29,941	23,004	14,322	14,379
Iran	32,841	36,615	21,038	9,314	2,702
Egypt	31,790	24,503	14,054	7,298	10,598
Mexico	21,743	17,695	13,233	7,535	7,647
Saudi Arabia	6,615	10,370	11,382	6,355	4,751
Canada	13,492	11,891	11,257	5,507	2,306
Taiwan	10,244	10,132	10,910	6,767	7,575
Other	149,385	105,953	104,981	65,198	55,405
Total	381,961	359,676	326,073	202,873	174,299

New Zealand Cheese Exports (Tons)					
Partner Country	Calendar Year			Jan - Aug	
	2002	2003	2004	2004	2005
Japan	42,890	44,697	52,793	33,744	37,077
Australia	37,826	34,257	39,349	28,307	26,599
United States	47,252	36,671	36,772	25,869	21,288
Korea South	10,570	11,195	16,380	11,271	7,700
Belgium	18,865	29,435	15,643	12,133	9,024
Mexico	13,907	15,931	12,366	8,245	8,407
Philippines	9,081	10,313	12,148	7,682	5,443
United Kingdom	16,271	18,296	11,071	8,203	7,057
Saudi Arabia	9,506	10,345	8,869	6,196	7,386
Taiwan	5,632	5,958	7,247	5,119	4,414
Egypt	6,104	6,195	5,070	4,223	4,815
Jamaica	3,243	3,167	4,576	2,326	2,351
Trinidad & Tobago	2,206	3,099	3,819	2,371	3,364
Russia	2,257	2,404	3,625	2,180	1,481
Malaysia	2,890	3,147	3,567	2,346	1,815
China	1,469	2,352	3,242	2,333	2,669
Other	48,398	47,471	40,481	27,394	30,847
Total	278,367	284,933	277,018	189,942	181,737

New Zealand Nonfat Dry Milk Powder Exports (Tons)					
Partner Country	Calendar Year			Jan - Aug	
	2002	2003	2004	2004	2005
Philippines	24,293	49,066	39,803	24,798	29,567
Malaysia	20,316	24,582	29,320	20,868	11,479
China	19,767	20,716	26,966	18,243	12,693
Thailand	22,939	19,581	20,438	12,664	9,844
Japan	29,162	12,841	16,031	11,328	7,391
Indonesia	23,545	15,452	14,714	9,786	8,016
Saudi Arabia	12,428	14,114	12,962	7,290	8,997
Singapore	8,014	11,757	12,049	8,294	9,472
Mexico	25,082	10,017	10,061	9,235	4,140
Taiwan	13,400	10,857	9,411	6,347	6,601
Yemen	3,238	3,360	6,925	3,578	1,188
Australia	1,406	4,506	6,101	3,235	4,569
Vietnam	13,387	9,519	5,638	3,632	2,906
Other	98,544	80,897	39,138	24,853	17,700
Total	315,521	287,265	249,557	164,151	134,563

New Zealand Whole Dry Milk Powder Exports (Tons)					
	Calendar Year			Jan - Aug	
	2002	2003	2004	2004	2005
China	54,836	77,461	86,010	68,821	34,226
Saudi Arabia	25,809	30,126	48,398	28,065	38,140
Sri Lanka	29,739	38,526	43,378	28,820	32,514
Malaysia	46,234	51,560	40,567	27,485	17,180
Venezuela	21,357	43,292	34,869	16,832	14,824
Philippines	29,958	36,582	31,442	17,677	17,574
Mexico	25,042	39,862	27,786	19,754	21,696
Thailand	24,796	33,735	27,489	18,982	11,789
Oman	8,465	14,588	26,579	15,871	7,786
Algeria	15,246	16,894	24,670	17,490	16,782
Cuba	15,912	15,331	24,223	12,588	9,818
Indonesia	38,983	37,583	23,731	12,456	20,779
Canada	20,518	21,127	23,655	14,406	15,454
Taiwan	20,000	17,759	19,412	12,702	11,552
Nigeria	3,076	10,356	19,109	18,589	4,438
Vietnam	13,893	30,450	16,568	12,634	8,535
Singapore	15,066	11,999	13,013	9,997	13,445
United Arab Emirates	8,555	6,249	11,043	3,328	10,933
Japan	8,101	10,226	9,497	7,418	4,114
El Salvador	13,154	11,796	7,947	5,478	5,545
Australia	7,318	6,142	7,681	5,263	3,686
Mauritius	3,366	5,084	5,350	3,408	3,557
Hong Kong	3,318	2,342	3,865	3,068	866
Guatemala	4,971	4,352	3,797	2,595	1,909
United States	3,353	3,213	3,691	2,799	2,203
Other	67,914	60,966	45,360	27,703	38,915
Total	528,980	637,601	629,130	414,229	368,260

**SECTION III. SUPPLY, DEMAND POLICY AND MARKETING****PRODUCTION**

New Zealand's milk production during the 2005/06 season (June-May) is forecast at 14.1 million tons, a 2 percent decline from the previous season. This is the second season of low milk production in a row and is well below that of 2003/04. The decline is due to poor weather conditions, resulting in decreased production per cow. This is despite a small increase in cow numbers (less than 1 percent).

Although currently lower than last season, milk flows have been mixed during the season to date, mirroring unpredictable weather patterns. A mild winter in 2005 was initially followed by a dry, warm spring. This resulted in rapid pasture growth in August throughout New Zealand. As a result, milk flows were ahead of the 2004/05 season, when farmers had faced undesirable weather conditions.

The poor weather conditions of the 2004/05 season caused milk flows to decline 4 percent during the season (note: this is a revision of Post's earlier forecast, see NZ5007). These conditions also impeded cows getting back into calf, which has resulted in a more spread out calving period during the 2005/06 season. This has created a more extended period between the first and last cows beginning milking during the current season, which should have made the peak milk flow occur after the typical late-October peak. Instead, peak milk flow was in mid-October and was not as large as in previous years. In Waikato, one of the North Island's major dairy regions, the peak occurred late September, which is seen as very unusual. This was the result of colder than normal conditions throughout New Zealand during October. Milk flows also decreased as a result of persistent rain and lower soil temperatures in some key North Island districts. Milk flows in the South Island have not been as adversely affected, but some areas are now potentially facing drought conditions. October conditions have meant that as of the beginning of November, milk flows are approximately 2 percent below the same time the previous season.

Dairy cow numbers continue to increase, but at a much slower rate than in previous years. Post forecasts an increase of less than 1 percent in cow numbers for the 2005/06 season. There are several reasons for this. The primary cause is competing land use. Other industries, such as sheep, have performed strongly in recent years and dairy farmers are competing with other farmers to find and convert suitable land. This growth in many sectors has rapidly increased land prices. In addition, many analysts are forecasting lower future payouts to farmers, while at the same time the fair value share price of Fonterra shares continues to increase. Combined with the rapid increase in land prices, it now takes farmers much longer to regain the value of their investment. There is also increased scrutiny on the environmental impacts of dairy farming and access to irrigation water is becoming increasingly difficult in many areas.

**TRADE**

Declines in export volumes during the 2004/05 season were much greater than the 4 percent drop in production. This was the result of Fonterra retaining inventory for selected customers as a result of tight supply in international dairy markets. This follows Fonterra's controlled inventory reduction during 2002 and 2003. Inventory levels are forecast to be maintained at these increased levels during the 2005/06 season as a result of milk flow being forecast to decline 2 percent below the previous season's. This retention, rather than building, of inventory levels will result in dairy product exports increasing, despite the decline

in milk flows (note: although the trends in Fonterra's inventory stocks are known, actual figures and percentage changes are not publicly available).

There have been small shifts in Fonterra's production focus. Last season there was a increased emphasis on WMP and protein products at the expense of SMP production. This is forecast to continue through 2005/06. New Zealand's tight milk supply last season, combined with a similar situation in Australia, contributed to maintaining strong dairy commodity prices. Tight supply is forecast by post to continue during the 2005/06 season. Strong commodity prices have been beneficial to Fonterra overall, but negatively affected the results of Fonterra Brands and Fonterra Specialty Products, the cooperative's value added businesses. New Zealand's currently strong exchange rate, however, has greatly reduced returns to Fonterra's New Zealand farmer-suppliers.

### **Butter**

New Zealand's butter production is forecast to decline 4 percent to 330,000 tons. Exports are forecast to increase 4.5 percent to 305,000 tons for the 2005/06 season as inventory levels are maintained rather than increased. Note that butter figures include anhydrous milk fat.

### **Cheese**

New Zealand's cheese production for the 2005/06 season is forecast to decline 1.7 percent to 295,000 tons. Exports will increase by 11.5 percent to 298,000 tons as a result of not building inventory levels.

### **Non-Fat Dry Milk**

Non-fat dry milk powder (skim milk powder) production in New Zealand for the 2005/06 season is forecast to decline 4 percent to 240,000 tons. Exports are forecast increase 6.5 percent to 236,000 tons, as a result of not increasing inventory retention levels.

### **Full Fat Dry Milk**

New Zealand's full fat dry milk (whole milk powder) production is forecast to decline 1 percent to 642,000 tons in the 2005/06 season. Exports are forecast to increase 10 percent to 642,000 tons as a result inventory levels being maintained.

## **MARKETING**

### **Domestic Brand 'Swaps'**

Fonterra purchased NZ\$ 754 million of assets from New Zealand Dairy Foods, in return selling the company NZ\$ 416 million of its assets, in August 2005. The brands Fonterra has purchased include domestic ownership of Anchor, which is one of the cooperative's key international brands outside New Zealand. Fonterra views this as greatly beneficial to the cooperative's long-term aim of its international brand consolidation. Fonterra outbid several competitors for the New Zealand Dairy Foods assets, including San Miguel, who it earlier lost out to in its bid for Australian dairy company National Foods (see NZ5007).

## Fonterra's International Market Strategy

Since its formation in 2001, Fonterra has repeatedly stated its goal to continue the work of its predecessors towards global dairy industry leadership. Fonterra has stated that its goals are for long-term competitiveness and cost leadership; to remain a farmer-owned cooperative; and the continued expansion of its value-add activities. It has been observed by some analysts, however, that New Zealand farmers can no longer produce milk for the lowest cost internationally. In its 2004/05 Annual Report, Fonterra also states that it aims to make dairy an integral part of peoples nutrition everywhere, create an integrated cow to customer value chain and to ensure that when people think dairy they think Fonterra.

Due to the significant trade barriers facing New Zealand dairy products in overseas markets, ongoing future growth will largely come from international acquisitions, mergers, and joint ventures and not from New Zealand-based dairy export increases. Although Fonterra is forecasting continued growth of New Zealand's milk production, the volume of milk the cooperative sources outside of New Zealand and Australia continues to grow more rapidly than domestically sourced milk. Currently Fonterra controls more than one third of world dairy trade and continues to increase its share. This has proven vital recently, with New Zealand's unexpected decline in milk production. Fonterra had earlier stated that it needed a growing capital base, which the forecast growth of 3 percent per annum covered (see NZ5007). However, Fonterra has more recently stated that it can no longer rely on a constant 2 to 3 percent per annum growth rate in New Zealand. Combined with the limitations of New Zealand's nine month milk season, Fonterra has been motivated to develop a global network of supplier partnerships to ensure availability of ingredients. As a result, Fonterra accesses product internationally via both established relationships and the spot market, allowing it to guarantee a consistent supply of product to its international customers. This is designed to reduce the supply fluctuation risk to customers' primary sourcing product from Fonterra.

As part of Fonterra's international expansion it is consolidating its brands. During 2005 Fonterra eliminated more than a quarter of its international brands. The cooperative has stated that it aims to focus its resources on a limited number of 'power brands'. Fonterra is also planning to make the Fonterra brand internationally recognized by placing the Fonterra logo on its products. Currently the Fonterra name is relatively unknown at the consumer level.

## Fonterra's International Expansion

### Fonterra's Involvement in the U.S. Market

Fonterra has established a joint venture with United Dairymen of Arizona to build a dairy plant in Arizona. The plant will produce milk protein concentrate (MPC). United Dairymen will contribute capital to the project, while Fonterra will contribute intellectual property. United Dairymen of Arizona will benefit from the joint venture by gaining access to Fonterra's MPC technology and the ability to use the Fonterra relationships with key customers in the United States and Mexico. Fonterra will benefit from developing a strengthened supply to its customers in the U.S., where Fonterra is enjoying good market returns, a closer proximity to customers and the potential to export to nearby countries. Fonterra already sells MPC to North American customers from their New Mexico plant, jointed owned with Dairy Farmers of America, and from overseas supply.

### Fonterra Building its Australasian Base

Fonterra continues with its plans to become a leading player in the Australian dairy industry. Fonterra has begun to consolidate its Australian interests under its fast moving consumer goods business 'Fonterra Brands'. Fonterra's existing consumer businesses of Bonland and Peters and Browns have so far been consolidated into Fonterra Brands during 2005.

Additionally, Australian based dairy company Bonlac became a wholly owned subsidiary of Fonterra on September 1, 2005. This follows 94 percent of Bonlac shareholders voting in favor of the takeover in August. Fonterra is planning to optimize production at Bonlac plants and increase its milk supply. In September 2005, Bonlac announced an A\$ 24 million profit, which is a large increase over the previous year's loss of A\$ 83 million.

Fonterra has also purchased a Nestlé plant in Victoria, which it will integrate into its manufacturing business. It took over the plant in August 2005 and will use the plant to supply a range of powdered milk products to Nestlé. Following these acquisitions Fonterra controls approximately 20 percent of Australia's milk supply.

Fonterra is investing A\$ 22 million to build a dairy research center in Melbourne. Construction is set to start in 2006, with completion expected in April 2007. The center will employ approximately 150 people and develop innovative dairy products for overseas markets. Fonterra states that the center will complement its Palmerston North site in New Zealand, which will maintain its current research funding levels. Fonterra assessed many potential locations worldwide before selecting Melbourne.

### Other International Expansion

In May 2005, Fonterra announced the creation of a joint venture worth NZ\$ 100 million with Clover, South Africa's largest dairy group. The joint venture company will be called Clover Fonterra Ingredients. The new company will handle marketing of bulk dairy ingredients, mainly milk powder, in the sub-Saharan region of Africa.

## POLICY

### Fonterra's Farmer Payouts

The final payout to Fonterra suppliers for the 2004/05 season was NZ\$ 4.59 per kg of milk solids. This is much higher than the initial forecast payout. Analysts state that a worldwide shortage of dairy products helped maintain strong world prices. New Zealand also had a large production shortfall. Some analysts have stated that Fonterra reduced exports of product further than its production shortfall to ensure that it could adequately supply existing customers.

The initial forecast for the 2005/06 season was originally NZ\$ 3.85, but this was raised to NZ\$ 4 in October 2005. After repeated increases in Fonterra's forecast payout last season, many farmers are hopeful that this season's final payout will be much higher. Some analysts think that the payout is unlikely to increase far above the current forecast. This is because Fonterra can no longer hedge against New Zealand's currently strong currency as favorably as it has in the past.

### Other Dairy Companies Payouts

New Zealand has a small number of niche dairy companies that utilize the milk supply not controlled by Fonterra. The Tatua cooperative has traditionally paid higher returns to its 122 farmer-shareholders than Fonterra. This is due to its focus on producing specialized pharmaceutical products. During the 2004/05 season, however, its payout was lower than Fonterra's at only NZ\$ 4.29 per kg of milk solids. The primary reason cited by the company is rising commodity prices (the company purchases a lot of raw materials), which it can not pass onto to its own customers, reducing the cooperative's margins.

Westland is a dairy cooperative based on the West Coast of New Zealand's South Island. Its payouts to its approximately 370 farmer-shareholders are generally lower than Fonterra's, but usually not by a significant amount. The payout for the 2004/05 season was NZ\$ 4.47 per kg of milk solids (about half of the suppliers also supplied colostrum, worth an additional 6 cents per kg). The cooperative argues that it provides better returns to its farmer-suppliers as its share price is lower than Fonterra's (NZ\$ 1.50 instead of NZ\$ 5.44), lowering barriers to supplying the cooperative. It provides other benefits to farmers that Fonterra doesn't. Westland produces mainly milk powders, but is investing in infrastructure to produce other products, such as casein. The cooperative argues that it can focus on market niches considered too small by Fonterra, which will ensure its long-term profitability.

### Fonterra Managing Industry Good Organization Dexcel

Dexcel and Fonterra entered into an agreement in May 2005 for Fonterra to provide strategic assistance and management services to Dexcel. Dexcel is a New Zealand industry good body that invests in research to improve dairy farm productivity. It is owned and levy funded by all New Zealand dairy farmers. This is a cause for some contention as not all of Dexcel's farmer-owners supply Fonterra. Some industry commentators are concerned that Fonterra may steer Dexcel's research towards its own aims, rather than benefit all New Zealand dairy farmers. Others see the agreement as an opportunity to more effectively achieve on-farm productivity gains and to possibly secure increased government funding. Fonterra continues to state that its aim is grow domestic milk production by 3 percent per annum and that it will proactively help farmers both on-farm and at a national level to do so. Fonterra states that its agreement with Dexcel is part of this strategy.

### Live Dairy Cattle Exports to China

A large number of dairy cows were exported live in 2004 (see NZ4019). Of the 65,000 exported, nearly 60,000 animals went to China. This market has changed drastically in 2005. For the year to August, only 7000 animals have been exported to China, while 24,000 have gone to Mexico. This boom in live dairy cattle exports is very recent, with total numbers of only 14,000 in 2003 and much lower numbers prior to this. Analysts are unsure as to reasons why exports to China have decreased so markedly, but think that it is due to tightening Chinese import regulations and poor 'after-sales service' by some vendors. Analysts anticipate some animal shortages in New Zealand and domestic prices are now close to those that can be received by exporting cows.

### Potential Benefits of Future New Zealand Trade Deals

A free trade agreement (FTA) between New Zealand and Thailand entered into force on July 1, 2005. Following implementation, 52 percent of New Zealand's exports to Thailand became

tariff-free. Prior to this only 4 percent were tariff free. The FTA will provide a significant boost for New Zealand's dairy exports. Thailand already represents Fonterra's 10th largest export market and generated NZ\$ 192 million (U.S.\$ 127 million)<sup>2</sup> of dairy export receipts in 2004. Tariffs on New Zealand infant milk formula, casein and lactose were eliminated on implementation of the agreement, while tariffs on yogurt, buttermilk, milk protein concentrate and butterfat are scheduled for removal in 2009. For whole milk powder, tariffs will reduce from 18 to 15 percent on implementation of the agreement, phasing to zero by 2020.

New Zealand, Australia and the Association of Southeast Asian Nations (ASEAN) negotiations for an FTA continue (see NZ5007). ASEAN is an important market for Fonterra as 20 percent of its production by value was exported to member countries in 2004.

The second round of FTA negotiations were held between New Zealand and Malaysia in July 2005 (see NZ5007). Negotiations were begun in March 2005. Dairy products valued at NZ\$ 260 million (U.S.\$ 172 million) were exported to Malaysia in 2004.

FTA negotiations between New Zealand and China continue (see NZ4019). China was New Zealand's second largest export market behind the United States in 2004, with exports valued at NZ\$ 365 million (U.S.\$ 240 million).

The Trans-Pacific Strategic Economic Partnership (Trans-Pacific SEP) is expected to begin January 1, 2006. This is based on New Zealand's FTA with Singapore, which entered into force in 2001. The FTA has been expanded to include Chile and Brunei. Tariffs on all dairy exports to Brunei are already zero, but a large number of tariffs placed on dairy products by Chile will be greatly reduced under the agreement. This will, however, have very little effect on New Zealand's dairy industry. New Zealand is already benefiting from the existing FTA with Singapore and both Chile and Brunei import only a modest amount of dairy product from New Zealand.

## ADDITIONAL RESOURCES

[www.fonterra.com](http://www.fonterra.com) (New Zealand's main dairy cooperative, 95 percent of exports)  
[www.westland.co.nz](http://www.westland.co.nz) (small dairy cooperative)  
[www.tatua.com](http://www.tatua.com) (small dairy cooperative)  
[www.maf.govt.nz](http://www.maf.govt.nz) (various reports on New Zealand's dairy industry)  
[www.lic.co.nz](http://www.lic.co.nz) (herd improvement cooperative)  
[www.dexcel.co.nz](http://www.dexcel.co.nz) (New Zealand's dairy industry research organization)  
<http://www.fedfarm.org.nz/fonterra.htm> (represents farmer interests, discusses capital structure and peak notes)

---

<sup>2</sup> Average exchange rate during 2004, NZ\$ 1 = U.S.\$ 0.664